

Message Text

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C O N F I D E N T I A L SECTION 01 OF 05 TOKYO 05375

EA FOR HEGINBOTHAM

USEEC
USOECN ALSO FOR EMBASSY

E.O. 11652: GDS
TAGS: EFIN, ECON, JA
SUBJECT: JAPANESE ECONOMIC OUTLOOK FOR 1978: UPDATE
REF: TOKYO 0874

1. SUMMARY: THIS MESSAGE UPDATES EMBASSY'S MID-JANUARY
REPORT ON DEVELOPMENTS IN AND THE OUTLOOK FOR THE JAPANESE
ECONOMY (TOKYO 0874). RECENT TRENDS HAVE REINFORCED OUR
JUDGMENT THAT THE OVERALL RATE OF REAL GROWTH FOR CY 1978
WILL BE ON THE ORDER OF 6 PERCENT. NO MAJOR CHANGES HAVE
BEEN MADE IN PREVIOUSLY ANNOUNCED FISCAL POLICY. THE
ANTICIPATED CUT IN THE DISCOUNT RATE BECAME EFFECTIVE
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MARCH 16. INDUSTRIAL PRODUCTION PERKED UP IN THE THREE
MONTHS BEGINNING NOVEMBER. INVESTMENT SURVEYS SHOW REAL
PRIVATE CAPITAL SPENDING ON TRACK TO DO AT LEAST AS WELL
AS OUR EARLIER FORECAST OF 4.5 PERCENT GROWTH THIS YEAR.
INVENTORY LEVELS APPEAR TO BE MOVING IN LINE WITH THE VIEW
PREVIOUSLY EXPRESSED THAT INVENTORY ADJUSTMENT SHOULD BE
SUBSTANTIALLY OVER BY MID-YEAR. THE OUTLOOK FOR CON-

SUMPTION REMAINS CLOUDY, BUT WE SEE NO REASON TO REVISE OUR FORECAST OF A 5 PERCENT REAL INCREASE, PARTICULARLY GIVEN THE CONTINUED IMPROVEMENT IN THE INFLATION PICTURE. THE CURRENT ACCOUNT SURPLUS REMAINS WORRISOMELY LARGE BUT NEW DATA FOR CY 77 AND RECENT MONTHLY DATA PROVIDE A LITTLE MORE PERSPECTIVE ON THE OUTLOOK FOR CY 78. AFTER THE LATEST RISE IN THE YEN EXCHANGE RATE, PASSENGERS AND CREW ON THE NIPPON MARU AGAIN LOOK A LITTLE WOBBLY AFTER A SPELL EARLIER IN THE YEAR WHEN THEY SEEMED TO BE GAINING THEIR SEA LEGS. END SUMMARY.

2. RECENT TRENDS: AFTER A PROLONGED LULL THROUGH MUCH OF 1977, INDUSTRIAL PRODUCTION PICKED UP IN NOV, WHEN IT ROSE 2.1 PERCENT, AND HAS GAINED A FURTHER 0.9 PERCENT IN EACH OF THE TWO SUBSEQUENT MONTHS. SHIPMENTS HAVE ALSO MOVED UP IN LINE WITH PRODUCTION, RISING AT AN ANNUAL RATE OF 22 PERCENT IN THE SAME 3-MONTH PERIOD. INVENTORIES HAVE HELD ABOUT LEVEL SO, OVERALL, A BETTER BALANCE BETWEEN INVENTORIES AND SHIPMENTS APPEARS TO BE DEVELOPING, ALTHOUGH THERE ARE STILL WIDE DISPARITIES AMONG THE INVENTORY POSITIONS OF DIFFERENT INDUSTRIES. NATIONAL INCOME DATA FOR CY 77 IV SEEM TO CONFIRM THE OFFICIAL VIEW OF THE ECONOMIC PLANNING AGENCY (EPA) THAT THE JAPANESE ECONOMY SUFFERED A SECONDARY, INVENTORY ADJUSTMENT PAUSE DURING 1977, CORRECTION OF WHICH SHOULD BE ACCOMPLISHED BY MID-1978. GNP DATA FOR 77IV SHOW REAL

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GROWTH AT A S.A.A.R. OF 4.0 PERCENT AFTER (DOWNWARD REVISED) GROWTH OF ONLY 1.6 PERCENT IN 77III. (DEVELOPMENTS IN INDUSTRIAL PRODUCTION IN FEB, RELEASED AFTER THE FOREGOING WAS DRAFTED, DO NOT LEAD US TO CHANGE OUR VIEW.)

3. FISCAL POLICY: AS ANTICIPATED, THE CENTRAL GOVERNMENT BUDGET FOR JFY 78 (BEGINNING APRIL 1978) PROVIDES FOR STRONG FISCAL STIMULUS FOCUSED ON A MAJOR EXPANSION OF PUBLIC WORKS SPENDING AND HEAVY DEFICIT FINANCING. CONTINUING THE PRACTICE OF RECENT YEARS, THE SPENDING PROGRAMS ARE TO BE FRONTLOADED TO HAVE THE MAXIMUM EARLY IMPACT. BASED ON THIS AND CARRYOVER PUBLIC SPENDING PROGRAMS INTRODUCED IN A JAN SUPPLEMENTARY BUDGET, WE EXPECT GOVT REAL INVESTMENT IN CY 78 WILL RISE ABOUT 16 PERCENT. BUDGETED SPENDING FOR GOVT CONSUMPTION IMPLIES A MORE SUBDUED GROWTH RATE OF ABOUT 5.5 PERCENT DURING CY 78. THE VERY LARGE PROJECTED GOVT BORROWING REQUIREMENT WILL SERVE AS AN OUTLET FOR THE HUGE SAVINGS FLOWS OF THE ECONOMY AT A TIME WHEN OTHER OUTLETS ARE LIKELY TO BE WEAK. NO FINANCING PROBLEMS ARE ANTICIPATED.

4. MONETARY POLICY IS EXPECTED TO BE ACCOMMODATING. THE

CUT IN THE DISCOUNT RATE TO 3.5 PERCENT EFFECTIVE MARCH 16 WILL FEED THROUGH TO REDUCED INTEREST COST FOR BUSINESS ALTHOUGH THE EFFECT ON INVESTMENT IS NOT EXPECTED TO BE SIGNIFICANT. FAVORABLE EFFECTS ON OTHER MARKETS (STOCK, BOND, REAL ESTATE) MAY PROMPT LESS RESTRAINED HOUSEHOLD SPENDING. GROWTH IN THE MONETARY AGGREGATES, WHICH HAD BEEN DECELERATING MUCH OF LAST YEAR, SHOULD PROCEED AT A MORE STABLE (SAY 10 PERCENT) RATE WITH RISING PRIVATE AND PUBLIC DEMAND FOR CREDIT.

5. PRIVATE INVESTMENT: THREE RECENT SURVEYS OF PRIVATE PLANT AND EQUIPMENT INVESTMENT FOR JFY 78 POINT TO SOME RECOVERY IN THIS SECTOR. THE BANK OF JAPAN PROJECTS A

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NOMINAL 10.7 PERCENT INCREASE, THE JAPAN DEVELOPMENT BANK 7.3 PERCENT AND NIHON KEIZAI 8.2 PERCENT. USING A PRICE DEFLATOR FOR INVESTMENT OF NO MORE THAN 3-4 PERCENT, AND ALLOWING FOR CY/FY DIFFERENCES, EMBASSY'S EARLIER FORECAST OF 2.5 PERCENT GROWTH IN PLANT AND EQUIPMENT INVESTMENT IN CY 78 APPEARS POSSIBLY CONSERVATIVE. A MAJOR EXPANSION IN ELECTRIC GENERATING FACILITIES AND MODERATE GROWTH IN THE SERVICE SECTOR ACCOUNTS FOR ALL THE GAINS; MANUFACTURING INVESTMENT IS EXPECTED TO DECLINE.

6. HOUSING INVESTMENT, AFTER A LULL IN 1977, IS EXPECTED TO BENEFIT FROM STRONG FINANCIAL SUPPORT FROM THE GOVT AND IS EXPECTED TO BE UP THIS YEAR ABOUT 8.0 PERCENT IN REAL TERMS. THE IMPACT OF EARLIER GOVT STIMULUS MEASURES IS REFLECTED IN THE STRONG FIGURES FOR 77IV (IN REAL TERMS UP 18 PERCENT AT A SAAR); MORE MONEY AND LOWER INTEREST RATES WILL BE AVAILABLE IN 78.

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7. WITH INVENTORIES COMING INTO BETTER ALIGNMENT WITH PRODUCTION AND SALES, WE EXPECT THE RATE OF STOCKBUILDING TO INCREASE ABOUT 25 PERCENT IN REAL TERMS IN CY 1978. THIS LARGE PERCENTAGE INCREASE IS FROM A LOW 77 BASE AND DOES NOT IMPLY A RAPID ACCUMULATION OF INVENTORIES.

8. CONSUMPTION GROWTH HAS BEEN FAIRLY ANEMIC FOR AT LEAST FIVE QUARTERS LARGELY BECAUSE REAL DISPOSABLE INCOME HAS BEEN RISING LESS RAPIDLY THAN GNP AND HOUSEHOLD SAVINGS RATIOS HAVE REMAINED HIGH. THE OUTLOOK FOR DISPOSABLE INCOME IS STILL A LITTLE CLOUDY; SLACK LABOR MARKETS IN KEY PATTERN-SETTING MANUFACTURING INDUSTRIES ARE GENERATING BUSINESS PRESSURE FOR SMALLER NOMINAL WAGE INCREASES THIS YEAR. WHETHER THIS WILL BE TRUE IN THE EXPANDING SERVICE SECTOR IS AN OPEN QUESTION. HOWEVER, EVEN WITH SLOWER GROWTH IN NOMINAL WAGES, THE DECELERATION OF INFLATION INSURES REAL WAGES WILL CONTINUE TO INCREASE. ALSO IT SHOULD REDUCE THE INFLUENCE OF FISCAL DRAG. ON BALANCE WE EXPECT A COMBINATION OF GROWING (IF SLOWLY) REAL INCOME AND POSSIBLY EASING SAVINGS RATES TO GENERATE REAL CONSUMPTION GROWTH OF ABOUT 5.0 PCT IN CY 78.

9. INFLATION SUBSIDED CONSIDERABLY IN 1977 AND THERE ARE NO SIGNS OF A RESURGENCE IN 1978. WHOLESALE PRICES HAVE BEEN VIRTUALLY UNCHANGED FOR THE PAST 14 MONTHS AND THIS PRIOR TREND WILL CONTINUE TO HAVE A DAMPENING INFLUENCE ON CONSUMER PRICES DURING 1978. WE EXPECT CONSUMER PRICES WILL SHOW AN AVERAGE INCREASE OF 5 PERCENT AND WHOLESALE PRICES A 2 PCT INCREASE. A FIRMING OF WHOLESALE PRICES IN SECTORS BENEFITING FROM PUBLIC WORKS SPENDING IN RECENT MONTHS HAS BEEN OFFSET BY THE EFFECTS OF CONTINUED YEN APPRECIATION.

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10. EXTERNAL ACCOUNTS: THE EXTERNAL ACCOUNTS CONTINUE TO PRESENT THE MOST PUZZLES AND THE MOST PROBLEM, BOTH FOR

POLICY AND PROJECTIONS. THE CURRENT ACCOUNT SURPLUS FOR CY 77 TOTALED \$11.1 BIL. IN JAN AND FEB THE SURPLUS (S.A.) WAS \$1.6 BIL AND \$1.9 BIL, RESPECTIVELY. THE COMBINATION OF SUBSTANTIAL EXCHANGE RATE APPRECIATION, STIMULATION OF DOMESTIC DEMAND, STABLE FOREIGN DEMAND, SUBSIDIZED AND EMERGENCY IMPORTS, A VARIETY OF OTHER FACTORS OPERATING TO RESTRAIN EXPORTS, AND AN INTERNATIONAL PLEDGE TO REDUCE THE SURPLUS IN FY 78 WOULD SEEM TO MAKE A REDUCTION OF THE SURPLUS DURING 1978 AN UNBEATABLE BET. THE TIMING AND MAGNITUDE OF THE EXPECTED TURNAROUND ARE MUCH MORE DIFFICULT TO FORECAST.

11. REVISED DATA NOW AVAILABLE FOR CY 77 SHED A LITTLE LIGHT ON HOW THE HUGE CURRENT ACCOUNT SURPLUS EVOLVED OVER THE PAST FEW QUARTERS. THE INCREASE IN THE SURPLUS IN 1977 TO \$11.1 BIL FROM \$3.7 BIL IN 1976 WAS ALMOST EXCLUSIVELY A RESULT OF PRICE MOVEMENTS. ALL OF THE INCREASED CURRENT ACCOUNT SURPLUS RESULTED FROM A \$7.6 BIL INCREASE IN THE TRADE BALANCE. AND IN THE TRADE ACCOUNTS, EXPORT VOLUME (YEAR-OVER-YEAR) WAS UP 3.0 PCT WHILE IMPORT VOLUME WAS UP 3.4 PCT. (SOME STATISTICAL ANOMALIES ARE NOTED BELOW.) DOLLAR PRICES OF JAPANESE EXPORTS ROSE 16 PERCENT (YEAR-OVER-YEAR, UNIT VALUE) WHILE DOLLAR IMPORT PRICES WERE UP A SMALLER 6 PCT. THE PATTERN OF IMPORT PRICES APPEARS TO REFLECT THE TREND OF WORLD PRICES WHILE THE INFLATION OF DOLLAR PRICES OF JAPANESE EXPORTS WAS PRESUMABLY DOMINATED BY EXCHANGE RATE MOVEMENTS. YEAR-OVER-YEAR, THE YEN APPRECIATED ABOUT 9.5 PCT. ON THE AVERAGE, AT LEAST UNTIL THE LAST QUARTER OF 1977, IT APPEARS JAPANESE EXPORTERS SUCCEEDED IN PASSING THROUGH THE EFFECT OF EXCHANGE RATE APPRECIATION TO HIGHER DOLLAR SALE PRICES. GIVEN THE STABILITY OF DOLLAR EXPORT PRICES OF JAPAN IN THE PREVIOUS TWO YEARS, THIS ADJUSTMENT DOUBTLESSLY TENDED TO BRING JAPANESE EXPORT PRICES MORE IN LINE

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R 311233Z MAR 78
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WITH WORLD TRENDS, IN DOLLARS.

12. THE INFLUENCE OF EXCHANGE RATES ON THE PRICES OF JAPANESE IMPORTS AND EXPORTS SHOW UP EVEN MORE CLEARLY IN THE SEASONALLY ADJUSTED MONTHLY DATA FOR UNIT VALUES EXPRESSED IN YEN (SEE TOKYO 03885). (DOLLAR UNIT VALUES ARE ONLY AVAILABLE ON YEAR-OVER-YEAR BASIS.) FROM DEC 76 TO DEC 77 THE YEN APPRECIATED 18 PERCENT, WITH MUCH OF THE RISE COMING IN THE FINAL QUARTER. YEN EXPORT PRICES SHOWED ONLY A SLIGHT DOWNWARD DRIFT IN THE FIRST FIVE MONTHS OF THE YEAR, INDICATING THAT MUCH OF THE EFFECT OF THE EARLY MODERATE YEN APPRECIATION WAS BEING PASSED THROUGH IN THE FORM OF HIGHER DOLLAR PRICES. (DOMESTIC WHOLESALE PRICES WERE STABLE THROUGHOUT THE YEAR.) BETWEEN MAY AND DEC, HOWEVER, THE YEN PRICES OF JAPANESE EXPORTS DROPPED A FULL 6 PERCENT, INDICATING THAT, ALTHOUGH DOLLAR PRICES WERE BEING PUSHED UP RAPIDLY, THE

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EFFECT OF THE STRONG APPRECIATION OF THE YEN WAS NOT BEING FULLY COMPENSATED FOR IN HIGHER DOLLAR PRICES.

13. WHILE CURRENCY APPRECIATING WAS BOOSTING THE DOLLAR

VALUE OF EXPORTS, FAVORABLE CIRCUMSTANCES IN WORLD MARKETS LATER IN THE YEAR WERE HOLDING DOWN THE DOLLAR PRICES OF JAPANESE IMPORTS. AGAIN THIS SHOWS UP IN THE YEN PRICES OF JAPANESE IMPORTS. FROM JUNE UNTIL DECEMBER, YEN IMPORT PRICES FELL 13 PERCENT, SLIGHTLY MORE THAN THE APPRECIATION OF THE CURRENCY, REFLECTING THE WEAKENING OF RAW MATERIAL PRICES IN THE SECOND HALF OF THE YEAR.

14. SOME EVIDENCE SUGGESTS THAT HIGHER EXPORT PRICES TOOK A TOLL ON JAPANESE EXPORTS DURING 1977. AFTER A STRONG FIRST QUARTER, EXPORT VOLUME GROWTH (S.A.) WITHERED THROUGH THE YEAR AND WAS VIRTUALLY FLAT IN THE LAST QUARTER. IMPORT VOLUME, REFLECTING THE PRICE INELASTICITY OF RAW MATERIAL IMPORTS, MOVED MORE IN LINE WITH THE WEAK INDUSTRIAL PRODUCTION TRENDS IN JAPAN. (HOWEVER, THE OECD, FOR EXAMPLE IN ITS ECONOMIC SURVEY: JAPAN, 1977, HAS QUESTIONED THE RELIABILITY OF THE SEASONAL ADJUSTMENT FACTORS USED FOR THE QUANTUM INDICES AND THIS EVIDENCE CANNOT BE CONSIDERED CONCLUSIVE.)

15. TRADE DATA FOR 1977 APPEAR TO SUPPORT THE CONCLUSION THAT THE DRAMATIC INCREASE IN JAPAN'S TRADE SURPLUS STEMMED FROM STRONG J CURVE EFFECTS ON EXPORTS, FAVORABLE DEVELOPMENTS IN WORLD PRICES OF IMPORTS LATER IN THE YEAR, AND LETHARGIC DEMAND AT HOME.

16. DURING THE FIRST HALF OF 1978 JAPANESE FIRMS WILL BE TRYING TO SORT OUT THE CHOICE AMONG CONTINUING TO RAISE THEIR PRICES ABROAD, LOSING MARKET SHARES, TURNING TO THE HOME MARKET, SWITCHING TO OTHER LINES OR GOING TO THE

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WALL. THE SUBSTANTIAL AND FAIRLY PROMPT INCREASE IN EXPORT PRICES FOLLOWING YEN APPRECIATION LAST YEAR, HOWEVER, SUGGESTS THAT JAPAN MAY BE WELL INTO THE J CURVE.

17. THE FIRST TWO MONTHS OF 1978 RAISE QUESTIONS ABOUT HOW SOON THE IMPROVEMENT (REDUCTION) IN JAPAN'S TRADE SURPLUS CAN BE EXPECTED. IMPORTS REMAINED LISTLESS WHILE EXPORTS REGISTERED GAINS OF 12 PERCENT, THE BULK DUE TO AN 8 1/2 PCT INCREASE IN VOLUME FOR THE TWO MONTHS. TEMPORARY CIRCUMSTANCES SUCH AS A REBUILDING OF CAR INVENTORIES IN THE U.S. AND PREEMPTIVE EXPORTS IN ANTICIPATION OF RUMORED CONTROLS, PROBABLY INFLUENCED THE RESULTS. FOR EXAMPLE, AUTO TRADE INDUSTRY FIGURES SHOW THE NUMBER OF PASSENGER CAR UNITS EXPORTED IN FEB WAS 22 PCT GREATER THAN THE YEAR-EARLIER FIGURE EVEN THOUGH THE INDUSTRY HAS BEEN FORECASTING LITTLE GROWTH ABROAD THIS YEAR, PARTICULARLY IN THE AMERICAN MARKET, BECAUSE OF YEN APPRECIATION. STILL THE FIGURES RAISE CONCERNS.

18. TAKING THE YEAR 1978 AS A WHOLE, WE ARE INCLINED TO BELIEVE EXPORT VOLUME GROWTH WILL BE SUBSTANTIALLY CURTAILED BY GROWING PRICE RESISTANCE ABROAD AND UNPROFITABILITY AT HOME. DOLLAR PRICES, HOWEVER, WILL PROBABLY BE PUSHED HIGHER IN DELAYED REACTION TO EARLIER APPRECIATION SINCE THE FIRST OF THE YEAR. PRICE EFFECTS WILL PROBABLY BE IN THE ASCENDENCY UNTIL MID-YEAR. IMPORT VOLUME CAN BE EXPECTED TO DEVELOP MORE STRONGLY LATER IN THE YEAR AS INVENTORY ACCUMULATION RESUMES. IMPORT PRICES WILL DEPEND PRIMARILY ON WORLD PRICE TRENDS.

19. THE INERTIA ALREADY BUILT INTO THE TRADE FIGURES, ALONG WITH CHANGED ASSUMPTIONS, MAKE IT DIFFICULT TO EXPECT THAT THE CURRENT ACCOUNT SURPLUS WILL BE HELD TO

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THE \$8 BIL IN CY 78 EARLIER FORECAST, THOUGH A DECLINING TREND THROUGH THE YEAR SHOULD BE EVIDENT. THE FIRST QUARTER OF CY 78 MAY WELL REACH OVER HALF OF THIS FIGURE, AND \$10 BIL NOW SEEMS A MORE LIKELY ESTIMATE FOR THE YEAR AS A WHOLE. IF OUR ASSUMPTION THAT THE CURRENT SURPLUS WILL CREST IN THE FIRST HALF OF CY 78 IS CORRECT, A STEADILY DECLINING SURPLUS SHOULD BE EVIDENT OVER THE COURSE OF JFY 78 (BEGINNING APRIL 1), THE PERIOD DURING

WHICH THE GOJ HAS COMMITTED ITSELF TO MAKE A SUBSTANTIAL
REDUCTION IN THE SURPLUS.

20. NOTE: SOME STATISTICAL ANOMALIES MAKE IT DIFFICULT
TO RECONCILE BALANCE OF PAYMENTS TRENDS WITH THE
NATIONAL INCOME ACCOUNTS. WHILE THE CUSTOMS TRADE DATA
FOR CY 77 SHOW EXPORT VOLUME INCREASED BY 3.0 PCT, THE
GNP FIGURES FOR CY 77 SHOW EXPORTS IN CONSTANT PRICES
INCREASED BY 10.4 PCT. WE ARE INFORMED BY EPA THAT THE
DISCREPANCY IS PRIMARILY DUE TO THE USE OF DIFFERENT
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DEFLATORS. EXPORT VOLUME IN THE GNP FIGURES IS CALCULATED
USING MAINLY THE BANK OF JAPAN EXPORT PRICE INDEX. THIS
INDEX DOES NOT INCLUDE PLANT EXPORTS AND SHOWED A 5.0 PCT
DROP IN YEN EXPORT PRICES IN 1977. THE QUANTUM INDEX FOR
EXPORTS IS CALCULATED USING THE MOF UNIT VALUE INDEX,
WHICH DOES INCLUDE PLANT EXPORTS. THIS INDEX SHOWED A 5.4
PCT INCREASE IN YEN EXPORT PRICES IN 1977. WE ARE TOLD
PRICE INFLATION IN THE RAPIDLY GROWING PLANT EXPORT
BUSINESS ACCOUNTS FOR MOST OF THE DIFFERENCE IN THE TWO
FIGURES. OUR ANALYSIS OF THE PRICE AND VOLUME TRENDS IS
BASED ON THE MOF SERIES FOR UNIT VALUES AND QUANTUM
SINCE THESE DATA APPEAR TO BE MORE COMPREHENSIVE AND
ALLOW A RECONCILIATION OF THE TRADE VALUE FIGURES.

21. ALTHOUGH WE NOW EXPECT THE CY 78 CURRNT ACCOUNT
SURPLUS TO BE LARGER THAN OUR JAN FORECAST, WE EXPECT THIS
TO BE PRIMARILY THE RESULT OF DOLLAR PRICE ADJUSTMENTS.
ON THIS BASIS WE HAVE LEFT UNCHANGED OUR ESTIMATE OF THE
NET EXTERNAL SURPLUS IN THE GNP ACCOUNTS.

22. WITH THE CURRENT ACCOUNT SURPLUS EXPECTED TO REMAIN
LARGE WELL INTO THE YEAR, THE PROBLEMS OF FINANCING THAT
SURPLUS ARE LIKELY TO CONTINUE TO RECEIVE CONSIDERABLE
ATTENTION. FULL YEAR FIGURES NOW AVAILABLE FOR 1977
SHOW JAPAN LAST YEAR RE-EMERGED AS AN IMPORTANT LONG-TERM
CAPITAL EXPORTER WITH SUCH OUTFLOWS EXPANDING FROM \$1.0
BIL IN 1976 TO \$1.7 BIL IN 1977. THE STRONG EXPANSION OF
THIS ELEMENT OF JAPANESE FOREIGN INVESTMENT WAS A
RESPONSE TO THE GOJ POLICY OF ENCOURAGING CAPITAL OUTFLOWS
THROUGH YEN BOND ISSUES BY FOREIGN GOVTS AND INSTITUTIONS
AND TO THE STIMULUS PROVIDED BY DECLINING INTEREST RATES
IN JAPAN. IF ANYTHING, THESE FACTORS WILL BE EVEN MORE
SIGNIFICANT IN 1978. THE POTENTIAL FOR SUBSTANTIAL
INCREASES IN LONG-TERM CAPITAL EXPORTS FROM JAPAN IS
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SUGGESTED BY THE PATTERN OF OUTFLOWS IN 1971-73 WHEN, IN SOMEWHAT SIMILAR CIRCUMSTANCES, LONG-TERM CAPITAL OUTFLOWS ROSE FROM \$1.1 BIL IN 1971 TO \$4.5 BIL IN 1972 AND \$9.9 BIL IN 1973.

23. THE SHORT-TERM CAPITAL ACCOUNTS WILL PROBABLY CONTINUE TO BE AFFECTED BY THE PRESSURES TO REPAY OUTSTANDING SHORT-TERM FOREIGN CURRENCY BORROWINGS AND TO SWITCH AWAY GRADUALLY FROM DOLLAR FINANCING OF TRADE TOWARD RELIANCE ON DOMESTIC YEN CREDITS.

24. AS DEVELOPMENTS OF THE LAST SIX MONTHS HAVE CLEARLY SHOWN, THESE UNDERLYING PRESSURES FOR CAPITAL OUTFLOWS CAN BE SWAMPED FOR SHORT INTERVALS BY VOLATILE CAPITAL INFLOWS MOTIVATED BY EXCHANGE MARKET EXPECTATIONS. THE GOJ HAS NOW TAKEN STEPS TO CLOSE OFF MOST OF THE EASY CHANNELS FOR NON-RESIDENTS TO ACQUIRE INTEREST-EARNING DOMESTIC JAPANESE ASSETS. ONE HUNDRED PCT RESERVE REQUIREMENTS HAVE BEEN IMPOSED ON INCREASES IN NON-RESIDENT FREE YEN ACCOUNTS AND A BAN HAS BEEN PLACED ON NON-RESIDENT PURCHASE OF DOMESTIC YEN BONDS WITH A REMAINING PERIOD TO MATURITY OF FIVE YEARS AND ONE MONTH OR LESS. OTHER CHANNELS STILL EXIST SUCH AS LONGER-TERM BONDS, EQUITIES AND LEADS AND LAGS. ON BALANCE THOUGH, ASSUMING A CALMER EXCHANGE MARKET, IT WOULD NOT BE SURPRISING TO SEE A FURTHER LARGE INCREASE IN NET JAPANESE CAPITAL EXPORTS OVER THE COURSE OF 1978.

FORECAST OF JAPANESE GNP (TRILLION YEN AT 1970 PRICES)

1977-78

-	CY	PERCENT	CY	PERCENT
-	1977	CHANGE	1978	CHANGE

PRIVATE CONSUMPTION 53.5 (3 1/4) 56.3 (5)

GOVT CONSUMPTION 8.6 (3 1/4) 9.0 (5 1/2)

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GROSS DOMESTIC FIXED

CAPITAL FORMATION	32.0	(4 1/2)	34.6	(8)
PRIVATE	21.9	(1 1/4)	22.9	(4 1/2)
- DWELLINGS	6.7	(-1 1/4)	7.3	(8)
- PLANT AND EQUIP.	15.2	(2 1/2)	15.6	(2 1/2)
GOVERNMENT	10.1	(12)	11.7	(16)
INVENTORIES	2.0		2.5	
EXTERNAL SURPLUS	6.4		6.1	
GNP	102.5	(5 1/2)	108.5	(6)

BALANCE OF PAYMENTS (\$ BIL)

CURRENT ACCOUNT (11) (10)

INFLATION (ANNUAL AVERAGE)

- CPI	(8.3)	(5)
- WPI	(1.9)	(2)

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Decaption Note:
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Disposition Comment: 25 YEAR REVIEW
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Disposition Event:
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Disposition Reason:
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Document Unique ID: 00
Drafter: n/a
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Film Number: D780140-0233
Format: TEL
From: TOKYO
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1978/newtext/t1978031/aaaaane.tel
Line Count: 583
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 9cee80b7-c288-dd11-92da-001cc4696bcc
Office: ACTION EA
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
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Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 03 may 2005
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SAS ID: 3095254
Secure: OPEN
Status: NATIVE
Subject: JAPANESE ECONOMIC OUTLOOK FOR 1978: UPDATE
TAGS: EFIN, ECON, JA
To: STATE TRSY MULTIPLE
Type: TE
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